FROM THE CAPITAL

It’s all relative

Being less ugly than others should be enough for mining equities

John Robertson*

The Apple share price has fallen 30%. That’s good news for the mining industry.

Among the investment market challenges confronting the mining industry over the past five years has been its inability to marshal a competitive investment proposition.

Investors sizing up the composition of their portfolios have seen historically poor mining industry conditions coincide with an array of outstanding returns elsewhere.

The stark disparity in performance has left a capital-hungry industry starved of funds and reeling in others’ wake.

While the Euromoney Global Mining Index, for example, fell 76% between the beginning of 2011 and the end of 2015, the S&P 500 rose 63%. Within that, even the battered financial services component added 47%.

The technology-oriented NASDAQ composite index rose 89%. A 265% gain in NASDAQ biotech investments was driven by advancing science, new drug discoveries, innovative medical interventions and the expanding healthcare needs of aging populations.

Investor attention was grabbed by the likes of Amazon, Facebook, Twitter, Google and Apple, which added an average 110% to their values as they injected themselves into the social and economic fabric of the global economy and even as the share price of Twitter nearly halved.

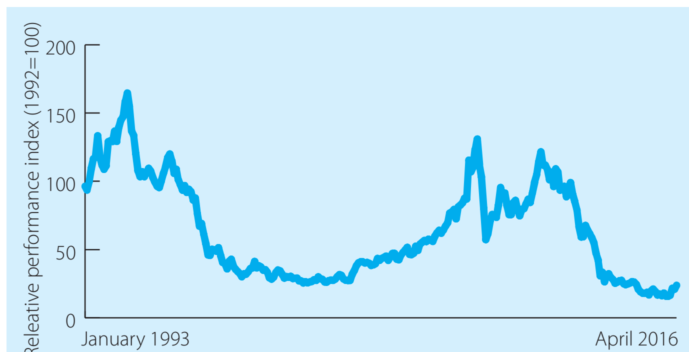
In Australia, where banks and resources have historically been the two biggest market sectors jostling for a share of investment portfolios, the difference in price performance was a massive 126 percentage points. The four major banks also offered annual dividend yields of as much as 5-7%. Dividend imputation added more.

From a geographic perspective, European and Japanese equities were safer havens than resources despite anaemic growth outcomes in those two economies. Emerging markets were a weak spot on the equity horizon, but even the 31% loss suffered by the MSCI emerging market index was a better outcome than the one offered by the related mining industry.

Beyond equities, bond prices continually defied the predictions of forecasters. The US 10-year government bond price rose 47%. The Merrill Lynch high-yield corporate bond total return index added 27%.

Yield hungry investors managing their superannuation money with an eye to retirement would have foolishly held mining companies in their portfolios when these other investment gift horses were staring them in the face.

Weak selling prices, a deteriorating discovery track record and outstanding investment results



ASX small resources vs banks relative performance

Mining as an investment is making a comeback thanks to the poor performance of other sectors

almost everywhere else were an effective ‘Do Not Enter’ sign at the doorway to the mining industry.

A detectable change in momentum is underway.

Australian investors, for example, who are responsible for a disproportionate share of mining industry funding, have no more important choice than the relative weighting between banks and resources: get that right and little more needs to be done to outperform the major Australian equity market benchmarks, given the respective weightings of the two sectors.

The necessity to switch between the two sectors occurs infrequently. Throughout the past five years, the balance of risks has favoured retaining positions in the banks in preference to an exposure to natural resources.

More recently, the balance of risks has moved toward a more neutral positioning as the resources/banks relative performance has started to resemble the outcome in the late 1990s.

Then, several more years were needed before evidence of a clear-cut cyclical swing would emerge, but the incentive to choose one sector over the other had been neutralised.

As some of the most intense cyclical pressures on the miners have eased, pressures on financial institutions world wide have intensified. Prolonged low or falling interest rates combining with more aggressive regulatory regimes contain warnings about future earnings. Some of the most lucrative sources of bank profits historically are being amputated at the behest of policymakers afraid of another financial crisis.

More broadly, some traditionally attractive equity market segments have lost their appeal.

Department stores around the world have been struggling to reassert their relevance. In the US, where internet sales have grown to 8% of total retail sales, logistics providers are increasingly dominant influences on decisions about how retail transactions are undertaken. The movers of goods are dictating the profit margins of ‘bricks and mortar’ sellers of goods.

Some thought Apple’s capacity for innovation was so far ahead of anyone else that it could buck the trends that crippled the short lived business ascendency of Palm, Nokia and Blackberry, all once dominant in their personal technology market segments. Apple doubters are starting to proliferate.

And even the best of the survivors are becoming more expensive. Standard and Poor’s has estimated that the S&P500 stocks are trading at a daunting 24 times trailing earnings.

There’s still little meaningful improvement in commodity prices. Global growth momentum seems insufficient to rebalance raw material markets any time soon. But, despite these still missing ingredients, mining investments are becoming more competitive.

Today, an equity portfolio manager should feel obliged to consider a place for mining stocks simply to acknowledge the shift in relative risk profiles among the different equity market segments. ■

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